STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company	)	
	)	01-0645
Petition for Certificates of Public Convenience and Necessity to provide water and/or sanitary sewer service to parcels in DuPage and Will Counties, Illinois, pursuant to Section 8-406 of the Public Utilities Act.	)	

REPLY BRIEF OF ILLINOIS-AMERICAN WATER COMPANY

I. INTRODUCTION

In this proceeding, Illinois-American Water Company ("I-AWC" or "Petitioner") expressed arguments in its Initial Brief that are not addressed by the Staff of the Commission ("Staff") in its Initial Brief. First, "special contracts" are required by the provisions of tariffs of Citizens Utilities Company of Illinois ("CUCI") for sewer main extensions of the type involved in this case (I-AWC Init. Br., p. 3), and such contacts have been consistently approved by the Illinois Commerce Commission ("Commission") for many years. (See: Citizens Utilities Company of Illinois, Docket 94-0481, Order entered September 20, 1995; Citizens Utilities Company of Illinois Extension of Sewer Mains, Sheets 25-27, effective September 20, 1995; I-AWC Init. Br., p. 3). The use of special contracts for sewer service that did not require refunds was approved, for example, in Citizens Utilities Company of Illinois, Docket 97-0383, Order entered January 21, 1999, based on the recommendation of Staff witness Roy A. King. Second, in its Initial Brief, Staff does not address I-AWC's position that, if the Commission wishes to promulgate rules for sewer service or modify the provisions of CUCI's effective tariffs, the appropriate way to do so is by a generic rulemaking docket or citation proceeding, respectively. [IAWC Ex. 2.00, pp. 5, 7-8]. Third, in its Initial Brief,

Staff does not address I-AWC's position that developers are the only winners if Staff's sewer refund proposal is adopted. Under Staff's approach, as discussed in I-AWC's Initial Brief (pp. 7-8), customers could be required to pay the cost of sewer facilities twice, once in the cost of their homes and again in their sewer rates.

Subsequent to the filing of the initial briefs in this matter, on June 28, 2002, the Illinois Appellate Court, Second District issued its opinion, in the "Terra Cotta" appeal, 2-01-0746 & 2-01-0752 cons. (hereinafter the "Terra Cotta decision"). In that opinion (slip. op., p. 7), the Appellate Court made clear Part 600 does not apply automatically to sewer utilities. Instead, the Commission must evaluate the reasonableness of a special contract based on the evidence presented with regard to the "particular agreement at issue" (slip. op., p. 7). The Court's opinion indicates that, while the Commission may consider the provisions of Part 600 in connection with its review of a sewer facilities contract (slip. op., p. 7), it must also consider evidence presented with regard to case-specific provisions of the particular contract (slip. op., pp. 8-9).

The evidence of record in this proceeding (which includes uncontraverted evidence detailing the effect of Staff's proposal on Metro Division rates; IAWC Exs. 1.0R, pp. 8-11, 1.1R, 1.2R) demonstrates that Staff's position should be rejected. Staff does not rely in its Initial Brief on any study or analysis conducted by Mr. King for the purpose of this proceeding. Indeed, Mr. King admitted on cross-examination that he did not prepare any workpaper, study or analysis related to the impact of his proposal in this case on the rates of customers, the cost of sewer facilities or CUCI's rate base levels. (Emphasis supplied). (Tr. 96-97) Also, as discussed above, the provisions of CUCI's effective tariffs related to sewer main extensions of the type involved here expressly authorize the use of special contracts, which have never provided for developer refunds. [IAWC Ex. 1,0R, pp. 5-7] There is no indication in Terra Cotta that such tariff provisions and/or consistent historical approach applied to the combination water supply facility and sewer facility agreements at issue in that case (slip. op., p. 6). Based on the opinion in Terra

Cotta, Staff's position that the combined water and sewer facility extension agreements in this proceeding must provide for developer refunds should be rejected.

II. ARGUMENT

A) Staff's contention that when I-AWC sewer revenues are spread over the entire Metro Division the annual increase in customer sewer rates would only be $1.00 is wrong.

Staff suggests that, under its sewer refund proposal, the annual rate increase to each I-AWC customer is only $1.00. (Staff Init. Br., p. 10). Staff's position, however, is incorrect, not supported by the record and totally refuted by IAWC Exhibit 1.1R, which calculates an annual increase of $47.90 per customer for the I-AWC Metro Division, or an annual increase of 14.7%. As was explained in I-AWC's Initial Brief (pp. 4-5), undisputed evidence presented by Bob Khan shows, inter alia, that, for the Metro Division, acceptance of Staff's approach would raise the level of rate-payer supported investment in sewer facilities an average by 24%. [IAWC Ex. 1.1R] The undisputed evidence also shows that this increase in rate-payer supported investment would require an annual increase in rates of the Metro Division of $47.90 or 14.7%. [IAWC Ex. 1.1R] In his Rebuttal Testimony, Mr. King did not address Mr. Khan's analysis at all (and, as already discussed, Mr. King prepared no rate or cost analysis of his own (Tr. 97)). Thus, Mr. Khan's analysis of the rate impact of Staff's proposal stands undisputed in the evidentiary record.

In its Initial Brief (pp. 9-10), Staff states its position, " . . . that the revenue [referring to the increased revenue requirement arising under Staff's proposal for the projects involved in this proceeding ("Projects")] when spread over the Metro Division customer base, would be approximately $1.00 annually." Staff cites nothing to support this "position" and, in fact, there is no record support. Staff's statement is extra-record and must be ignored. 220 ILCS 5/10-103 (decision of the Commission must be based exclusively on the record). Indeed, as Staff

recognizes in a footnote to its Initial Brief (p. 10, fn. 3), Mr. Khan expressly rejected Staff's calculation. [Tr. 69]

Because the $1.00 calculation appears in Staff's Initial Brief (although improperly), I-AWC will respond to the substance of Staff's stated "position." As discussed above, Staff's position in this case is not related to specific circumstances of the Projects. As has been discussed, Mr. King made no consideration at all of the cost characteristics of the Projects or their effect on rates or rate base. [Tr. 97] Rather, Staff's view (Staff Init. Br., p. 2) is that the agreements at issue should have refund provisions because Part 600 requires such provisions for water main extension agreements. This "logic", however, would apply, not just to the agreements in this proceeding, but to all sewer facilities contribution agreements. Thus, Staff's approach, if accepted, would require that refunds always be required for sewer extension contracts. The $1.00 analysis developed by Staff for its Initial Brief, however, assumes that the Projects are the only main extensions supported by rates in the entire Metro Division. This assumption is nonsense. Staff's $1.00 analysis, therefore, is, not only extra-record, but also misleading and disingenuous. I-AWC Exhibit 1.1R, on the other hand, properly shows the overall effect of adopting Mr. King's approach for all sewer extension agreements (as is consistent with the rationale offered by Staff to support the proposal, i.e., consistency of sewer extension provisions with Part 600 and uniformity of approach for water and sewer agreements).

B) There is no evidence that I-AWC will accumulate sewer assets with little or no investment, thereby realizing a "windfall" on the sale to a regulated utility.

Staff's contends in support of its sewer refund proposal that I-AWC will receive a windfall gain on the sale of contributed sewer facilities. Much of Staff's testimony concentrates on the irrelevant and misleading contention that I-AWC will receive the $907,265 windfall gain. (See: Staff Exhibits 1.00, pp. 9-12 and 2.00, pp. 4-5; Staff Init. Br., pp. 4-6).

As Mr. Khan explained, however, there is no "windfall" associated with a contribution to a regulated utility because the property contributed is deducted from the utility's rate base.

Mr. Khan pointed out that, when utility property is sold to another regulated utility, the acquiring utility continues to deduct the property's cost from rate base. (IAWC Ex. 1.0R, pp. 4-5) Mr. King acknowledged that contributed property would be deducted from rate base. (Tr. 112, 114-115). Ultimately, Staff agreed that a "windfall does not occur from a regulatory standpoint." (Staff Init. Br., p. 5).

As Mr. King indicated, the only possibility for a windfall gain would be on a sale of contributed facilities to a municipally owned system. (Tr. 111). The possibility of such a sale with respect to the facilities involved here, however, is purely speculative. Moreover, the Commission would not have jurisdiction over such a sale to an acquiring municipality. (Tr. 112).

Staff continues to refer (Init. Br., p. 6) to the acquisition of CUCI's assets by I-AWC, as approved by the Commission in Docket 00-0476. As both Mr. Khan and Mr. King indicated, however, from a regulatory standpoint, there is no "windfall" on receipt of a contribution. [IAWC Ex. 1.0R, p. 4, Tr. 52 (Khan); Tr. 114-115 (King).] Any contributed assets paid for by I-AWC utility would not have any impact on Metro Division customers' rates because the cost of such assets would not be part of I-AWC's rate base. [IAWC Ex. 1.0R, pp. 4-5, IAWC Ex. 2, pp. 1-2, Docket 00-0476, Order at 45-47.] Thus, Staff's statement that the "Company's witness provided no evidence contradicting Mr. King's conclusion that the company would gain $907,265" is, at best, disingenuous and, at worst, misleading and contradictory to Staff's own testimony and cross-examination.

C) Staff failed to support its contention that the failure to provide sewer refunds in Petitioner's special contracts is unreasonable and discriminatory and violates Sections 8-101 and 9-101 of the PUA.

Staff provided no legal support for its conclusion that the failure to provide sewer refunds in Petitioner's special contracts is unreasonable and discriminatory and violates Sections 8-101 and 9-101 of the PUA. As noted above, the Terra Cotta opinion of the Second District Appellate Court makes clear (slip. op., p. 7) that the provisions of Part 600 do not apply to sewer facility

agreements. Thus, each sewer special contract must be evaluated on the particular facts and circumstances involved. The absence of refunds in a sewer facility agreement, therefore, does not mean that the agreement is discriminatory. In Citizens Utilities Company of Illinois, a certificate case, Docket 97-0383, Order entered January 21, 1999, for example, the Commission approved sewer special contracts that did not require refunds at the recommendation of Staff witness King. Also, Staff did not object to Citizens' water and sewer and sewer special contracts in a certificate case subsequent to the Terra Cotta case, Citizens Utilities of Illinois, Docket 01-0259, Order entered July 25, 2001. As I-AWC explained in its Initial Brief: "Only unreasonable discrimination is prohibited." (I-AWC Init. Br., p. 6)

In alleging discrimination, Staff has made no attempt to show that the difference in approach between water and sewer agreements with regard to refunds is arbitrary or unreasonable. Mr. King admitted on cross-examination that there is a higher level of investment in sewer facilities than water facilities. (Tr. 121). Moreover, as Mr. Khan explained, the higher level of investment in sewer facilities requires that, to maintain reasonable rate levels, sewer facilities be treated differently than water facilities. [IAWC Ex. 1.0R, pp. 8-11.] As explained in I-AWC's Initial Brief (pp. 5-6), the special contracts at issue are reasonable, and not arbitrary or discriminatory. Sewer special contracts that do not call for refunds have been consistently approved by the Commission, and are just and reasonable.

D) Past actions by the Commission and other sewer utilities does not require I-AWC to provide sewer refunds.

On pages 7-9 of its Initial Brief, Staff contends that past actions of the Commission and other sewer utilities requires I-AWC to provide sewer refunds. In I-AWC's Initial Brief, pages 11-12, this contention was refuted.

The Appellate Court in the Terra Cotta decision stated on page 8, as follows: "Even if the Commission's order in this case is a departure from a prior decision, it is squarely within its authority to make two different determinations in two separate cases that each have different sets

of facts." Moreover, as also noted by the Terra Cotta decision, page 8: " . . . the Illinois Commerce Commission's orders have no res judicata effect in subsequent proceedings." As discussed in I-AWC's Initial Brief (p. 10), however, the Commission should provide a reasoned explanation when it determines to adopt a new approach. In this case, the Commission should approve the proposed sewer special contracts that do not require refunds to applicants. The Commission should explain that this approach is justified by the undisputed evidence showing the ratemaking implications of requiring a sewer refund provision. No such evidence was presented in Terra Cotta. The approach also is justified by CUCI's consistent application of the provisions of its effective tariffs that authorize the use of special contracts that do not require refunds.

IV. CONCLUSION

Based on the unrefuted record evidence presented by I-AWC in this case, the Commission should reject Staff's refund proposal and approve I-AWC's five special sewer contracts in this proceeding as written with no refund provisions.

Respectfully submitted,

Illinois-American Water Company

By:_____

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